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# San Diego Ahead In Pension Reform

*City Considers 401(k)-Style System*

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SAN FRANCISCO — Having already experienced a public employee pension-funding crisis, San Diego may emerge ahead of the reform curve as it works to clean up its financial house.

Suffering like many municipalities across the country from falling tax collections, the country's ninth-largest city may change its pension system to mirror corporate 401(k) programs. That could help reduce its $2.1 billion in unfunded liabilities and tackle a long-term burden on the budget.

Municipalities saddled with large and rising pension liabilities have raised concerns among investors and others about the potential for bond defaults. and even Chapter 9 bankruptcy.

The city has been reforming its pension system since a 2004 scandal involving its failure to fully disclose pension liabilities. That resulted in a settlement with the Securities and Exchange Commission.

Mayor Jerry Sanders, who was elected in 2005, took on the pension problems and changed the retirement formula for most new hires that started in 2009.

After San Diego voters shot down a sales tax increase in November that would have helped balance the budget, Sanders is again looking at pension costs.

He has proposed a plan to move all new employees from a defined benefit plan to a 401(k)-style program similar to those common in the private sector, termed a defined contribution plan, a strategy that only a handful of municipalities have adopted.

“The benefits that were negotiated or agreed to in the past are really unsustainable,” Jay Goldstone, the city’s chief operating officer, told The Bond Buyer in an interview. “We are stuck with the bad decisions that previous administrations and councils made, but we can stop the bleeding, or at least slow it down a bit.”

According to the formula used by many pension systems, an employee gets a percentage, usually between 1% and 3%, of their salary at a specified age, multiplied by their years of services, to come up with their annual retirement earnings.

As an example, Goldstone said a police officer or firefighter retiring at 50 after working for 25 years would get 3% of their salary at an average of their last three years and would collect 75% of that income annually. If that person lived until 80, that, he said, meant they could collect significantly more than they earned when they worked.

“The combination of all those was a formula for disaster and now we are seeing it,” Goldstone said.

The city has already negotiated lower pension benefits for most future hires. But Sanders and Goldstone want to go further.

The early outline of the pension reform for city employers would include a defined contribution plan with employee and employer matching contributions, participation in Social Security, and additional savings plans that do not include employer matches.

“We have not developed all of the details of the plan,” Goldstone said. “The safety net piece would be Social Security just like it is in the private sector, and then we would have an employer-employee match on a 401(k)-style plan.”

The 401(k)-type plan, aside from offering funding relief to governments, also offers the potential for employees to earn higher returns, and the risk of lower returns or losses.

But without specific details laid on the table, questions remain, including about savings.

A 2008 study of states by the Center for State and Local Government Excellence found that defined-contribution plans generally have higher investment and administrative expenses than defined benefit plans.

Another question is how much it would really change from the current second-tier system for new hires.

“The second tier is already a very modest plan, therefore moving to a 401(k)-style plan with Social Security may be an even trade,” said Mike Zucchet, general manager for the San Diego Municipal Employees Association. “With all that said, the answer is, I don’t know what we think of it because we don’t know what it is, really.”

He said the city is ahead in pension reform.

“We have been doing this for five years — to a larger extent, we are ahead of the curve on these reforms,” Zucchet said. “We are farther ahead of the game than a lot of cities.”

San Diego changed the retirement factors for new hires, excluding public safety employees, from 2% of high-year salary for every year they worked when they retire at 55 to 1% at 55, 2% at 60, or 2.4% at 65.

For police new hires, it changed the formula to 3% at 55 from 3% at 50. City officials are hoping to get similar concessions from firefighters.
The city cannot change benefits for employees hired under the defined-benefits plans because of vesting laws.

San Diego is not alone in push for reforms, though it is likely the largest of a few to move towards defined contributions similar to 401(k) programs.

Fort Lauderdale, Fla., put in place a similar defined contribution plan a few years ago and Cobb and Gwinett counties in Georgia have also instituted plans with defined contributions.

On a state level, Michigan and Alaska have adopted mandatory defined contribution plans, while Oregon and Indiana have implemented a mandatory hybrid plan, according to the Center for State and Local Government Excellence. Eight other states offer the option of a defined contribution plan.

Many local and state governments have also made less significant changes to their pension systems in recent years amid tightening budgets.

Chris Mauro, head of U.S. municipal strategy at RBC Capital Markets, said local governments are starting to follow the states' lead in pension reform in terms of increasing contribution and changing retirement formulas.

"I think this has become both a political and a financial issue," Mauro said. "Local governments are under significant budgetary pressure and that is obviously contributing to a desire to address at least one cost component they have control of, which is the pensions."